

CITY OF SAN DIEGO MEMORANDUM

DATE: June 1, 2005

TO: Honorable Mayor and City Council

FROM: P. Lamont Ewell, City Manager

SUBJECT: Reorganization and Fiscal Year 2006 Proposed Budget Unclassified
Position Impacts

As has been indicated during the course of the budget hearings, the challenges associated with developing the Fiscal Year 2006 Proposed Budget have necessitated that the process remain fluid. As information is refined, updates are provided to complete the proposed budget picture. Two areas that were still being defined as the Proposed Budget was being published include a limited restructuring of the organization and the proposed reduction of unclassified management positions. This memo is intended to explain the changes proposed in those areas.

In light of budgetary limitations, the Fiscal Year 2006 Proposed Budget focuses on core services and has resulted in a need to streamline the organization. This has been particularly difficult because the streamlining has resulted not only in structural changes to the organization, but also impacts to City staff. Though these decisions have been hard, they are necessary to help move the City forward. The recent press release by Fitch Ratings (see Attachment A) further emphasizes the City's need to implement difficult changes such as service reductions and personnel savings to achieve financial balance. In earlier discussions with the rating agencies, this effort was considered extremely important to the elimination of structural deficiencies embedded in previous City budgets.

Restructuring

Several organizational structure changes will be incorporated into the final budget and implemented as of July 1, 2005, or as close thereafter as possible. These changes will help achieve greater efficiency in the impacted areas and in some cases reduce the management staff required to manage the operations.

Community & Economic Development Department

The City Manager's "Recent Updates" section of the Fiscal Year 2006 Proposed Budget (Volume I, page 28) includes a proposal to transfer the Redevelopment Division of the Community and Economic Development Department (the City's Redevelopment Agency) to an agency, to be newly established, outside of the City. As described, this

proposed change to the City's Community and Economic Development Department would reduce the General Fund by approximately 22.70 positions. After additional consideration, this proposal will be implemented in phases, with Phase I consisting of a budgetary restructuring as an interim step. Phase II will consist of a policy decision by the Mayor and City Council after a more complete and detailed analysis is conducted on the options and impacts of the proposed spin-off.

Phase I, the budgetary element, can be completed within approximately 90 days of the budget adoption. It will entail isolating the costs and revenues currently associated with the Agency by creating a Special Fund to deposit existing tax increment dollars currently used to fund Agency staff and projects. This action will transfer 22.70 redevelopment positions from the General Fund to the new Special Fund, as shown on Attachment B. Though funded from a different source, the redevelopment functions will continue to remain part of the Community and Economic Development Department during this interim step, as will the economic development and community service functions.

Phase II, the policy discussion and decision, will include a comprehensive review and study of Mayor and City Council priorities, public input, legal considerations, internal and external impacts, and existing contracts and MOUs associated with the proposed spin-off. A timeline for the study will be developed once the parameters of the review are more fully detailed. A final report will be presented to the Mayor and City Council with policy decision options based on the factors mentioned above.

General Services Department

The Central Stores/Publishing Services Division of General Services will be separated and the two components placed within other divisions. Central Stores will become part of the Purchasing Division, which is in the Financial Management Department. Publishing Services will be joined with the Facilities Division of the General Services Department. This will eliminate the need for one deputy director position and place those functions in related service areas reporting to the deputy directors currently providing oversight. In addition, publishing operations are proposed to be relocated to the lower level of the Concourse. This move will result in rent being paid to the City, rather than a third party, which will become part of the revenue stream used to help offset expenses associated with Concourse operations. Additional information and the results of the Request for Proposals (RFP) will be provided within the next month.

The Airports Division of the Real Estate Assets Department will become a division of the General Services Department. There is no impact to Airports Division unclassified staffing levels associated with the transfer. This change will allow the Real Estate Assets Department to focus full attention on developing an asset management plan and addressing other important pending real estate issues.

Other

A final structural change is to the oversight responsibility for the Risk Management Department, which currently reports to the Human Resources Director. Given the financial nature of many of the risk management functions, the Risk Management Department will begin reporting to the Deputy City Manager responsible for finance on July 1, 2005. There are no impacts to staffing levels with this change.

Unclassified Position Impacts

The proposed streamlining has also resulted in staff impacts to departments funded by the General Fund as well as Non-General Fund sources, some of which are described above. The Proposed Budget as presented on May 2, 2005 included the proposed reduction of 355.33 positions. Subsequent review has resulted in a refined reduction of 350.93 positions across all levels of classifications, including unclassified and unrepresented. The difference is associated with proposed positions that were identified in multiple categories. Included in the refined figure is the reduction of 22.70 positions associated with the transfer of the Redevelopment Agency to the Special Fund, described above.

Of the 350.93 proposed position reductions in the Fiscal Year 2006 Proposed Budget, 28.8% are unclassified and unrepresented positions, which is a greater impact to the management level positions than has been seen historically. In Fiscal Year 2005, 229.73 positions were reduced and 23.87% were unclassified and unrepresented. In Fiscal Year 2004, 170.06 positions were reduced of which 12.20% were unclassified and unrepresented. Attachment C has been prepared as a comprehensive list reflecting all unclassified management level positions proposed for reduction, as described below.

Unclassified Position Reductions Included as \$1.6m Savings

The Citywide Program Expenditures budget includes a line item listed as "Personnel Savings Plan" (Volume II, page 74). This line item was included as a placeholder for management level positions proposed for reduction at a savings of \$1.62 million. The specific positions were not identified at the time the proposed budget was presented, but were intended to be identified prior to approval of the budget by the City Council. As shown in the first section of Attachment C, 10.80 unclassified management level positions totaling \$1.65 million have been identified for the proposed reduction. The additional \$30,000 in savings will be used to mitigate the loss of contingent revenue.

Unclassified Position Reductions Included in Department Budgets

As referenced above, 4.00 proposed unclassified management level reductions were reflected within specific departmental budgets. These are shown in the second section of Attachment C.

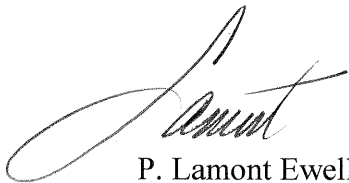
Additional City Manager Proposed Unclassified Position Reductions

The third section of Attachment C reflects other unclassified management level positions proposed for reduction in a continuing effort to flatten the organization.

Management duties will be redistributed within the impacted departments. Service levels of affected departments will be addressed through adjustments to priorities.

Upon approval of the budget, the reduction of the positions described above would be effective July 1, 2005. Unfortunately, the number of impacted employees exceeds the vacancies in both unclassified and classified areas. Impacted unclassified employees are being advised of job openings and given an opportunity to apply based on experience and qualifications. Impacted unclassified employees are also being advised regarding their ability to re-enter the classified service based upon work history, consistent with Personnel rules and regulations. Unclassified individuals may be able to compete for classified job opportunities as well. Labor Relations and Personnel staffs are working diligently to identify the placement of impacted employees as vacancies and rules allow. All involved are working to ensure the process goes as smoothly as possible for all employees.

This has been a challenging budget process and the decisions, particularly those that impact people's lives, have been very difficult. As I have indicated previously, the Fiscal Year 2006 Proposed Budget is focused on the City's provision of core services to the community and though challenging, streamlining has been a necessary part of the process. This is a recovery budget and with perseverance, the City will continue to move forward.



P. Lamont Ewell
City Manager

Attachments: A - Fitch Ratings Press Release, May 27, 2005
B - Redevelopment Agency Position Impacts
C - Unclassified Position Impacts



■ ■ Fitch Lowers \$1.95B Of San Diego, California Debt: Remains on Watch Negative

27 May 2005 2:06 PM (EDT)

Fitch Ratings-San Francisco-May 27, 2005: Fitch Ratings has downgraded the following ratings for the city of San Diego, California:

- \$22 million in outstanding general obligation bonds to 'BBB+' from 'A';
- \$250 million in leased backed debt to 'BBB-' from 'A-'.

Fitch also lowers the following:

San Diego Public Facilities Financing Authority

--\$1.1 billion in sewer revenue bonds to 'BBB+' from 'A'.

--\$287 million in subordinate water revenue bonds to 'BBB' from 'A-'.

San Diego Facilities and Equipment Leasing Corporation

--\$287 million in certificates of undivided interest, series 1998 (secured by a senior lien on water enterprise revenues) to 'BBB+' from 'A'.

All ratings remain on Rating Watch Negative by Fitch.

Fitch's rating actions reflects the city's continued delay in releasing its fiscal 2003 and 2004 audit and the negative effect the ongoing political conflicts and upcoming election have on the city's ability to resolve the its sizable financial challenges. Fitch continues to believe that San Diego's strong economic base and advantageous tax structure gives it a strong ability to pay, and that current credit quality concerns focus on the city's willingness to pay, hence the two-step rating difference between general obligation and lease secured bonds. Ratings for the enterprise system debt factor in the essential nature of these services.

Fitch believes that strong leadership and political consensus are needed to achieve budgetary balance in the next several fiscal years. In particular, Fitch notes the mayor's recent resignation announcement, upcoming election, and several ongoing investigations into criminal activity, irregular disclosure, and conflicts of interest as obstacles in drafting and adopting a sound budget for fiscal 2006. For future years, continued resilience to labor and constituent pressures will be needed to retain financial balance as pension contributions rise. Lastly, today's rating actions take into consideration mentions of bankruptcy by the city attorney and possible mayoral candidates, although the action remains strongly opposed by the mayor, city council, and city manager.

In retaining investment grade ratings on all city debt, Fitch recognizes the strength of the city's

economy and its diverse revenue stream that benefits from the economic activity. Liquidity concerns are alleviated by a tentative agreement with Bank of America for purchase of the city's tax and revenue anticipation notes. Fitch also notes that tentative labor agreements with four of the city's five bargaining groups take steps to reduce costs by freezing salary and benefit packages, requiring employee contributions to reduce the San Diego City Employees Retirement System's (SDCERS) unfunded actuarial accrued liability, and restricting certain retirement benefits for new hires. However, the current agreements do not realize all of the savings envisioned in the city's multi-year financial plan. For the city to achieve financial balance over the forecast period, service reductions and additional personnel savings are needed.

The ratings remain on Rating Watch Negative to reflect continued uncertainty regarding the city's ability to achieve budgetary balance over the next several years as the required pension contribution rises significantly.

Fitch views the audits' release date as uncertain, largely the result of a stalemate making the auditing firm, KPMG, unable to gain comfort that illegal activities have not taken place. The SDCERS board is reconsidering its prior refusal to provide certain documentation requested for KPMG, citing attorney-client privilege. The mayor, city council, and city attorney have requested that the board provide the documentation. As a positive development, the city has hired a firm specializing in forensic accounting to work with KPMG to achieve their satisfaction and enable an audit to be released.

In San Diego's multi-year financial forecast, alternative scenarios are considered, with the base case indicating financial balance if sizable labor cost reductions are made. Tentative agreements with four of the city's five employee bargaining groups come close to the plan's targets. Service reductions as have been proposed for fiscal 2006 by the city manager also will be necessary, again requiring strong fiscal discipline and political resolve by San Diego's leaders. Fitch is concerned that with investigations pending, allegations continuing, and a mayoral election pending, such cohesion and leadership are likely to continue to be absent.

Also, today's rating actions echo Fitch's previously expressed concern regarding the employee time and focus required to handle the multiple investigations underway, including those conducted by the Securities and Exchange Commission, Federal Bureau of Investigation, and U.S. Attorney. These efforts add to the city's work burden and distract needed attention from budgetary matters. Also, the District Attorney has indicated other charges will be forthcoming.

In an earlier rating downgrade, Fitch stated audited financial statements were needed to be able to view the city's financial condition as strong, as had been reported previously and is in accordance with prior year's operations. Nonetheless, Fitch's role as a rating agency dictates the responsibility to retain ratings whenever possible. Given the city's very strong reserve levels and financial operations through fiscal 2002 and the city's robust economy, Fitch expects the audited results for fiscal 2003 to be at least satisfactory.

Today's downgrade actions are in keeping with Fitch's emphasis on effective management as a key component of credit quality. Evidence of significant structural change and a resulting

positive effect are crucial to Fitch's returning San Diego's ratings to higher levels. In fact, Fitch believes the city has the potential to return to a position of above average credit quality based on its economic strength and ability to translate positive economic performance into sound financial operations through its varied tax structure. Fitch awaits release of the city's audited financial reports for fiscals 2003 and 2004 along with a sound and balanced budget for fiscal 2006 and further evidence of ongoing fiscal stability.

Other ratings downgraded and remaining on Rating Watch Negative by Fitch include the following:

San Diego, California

--Certificate of participation refunding bonds, series 2003 to 'BBB-' from 'A-'.

San Diego Metropolitan Transit Development Board

--Lease revenue bonds (San Diego Old Town Light Transit Extension Refunding), series 2003 to 'BBB-' from 'A-'.

Convention Center Expansion Authority

--Lease revenue bonds, series 1998A to 'BBB-' from 'A-'.

San Diego Public Facilities Financing Authority

--Lease revenue bonds, (Fire and Life Safety Facilities Project), series 2002B to 'BBB-' from 'A-';

--Sewer revenue bonds to 'BBB+' from 'A';

--Subordinate water revenue bonds to 'BBB' from 'A-'.

San Diego Facilities and Equipment Leasing Corp.

--Certificates of undivided interest (water revenue), series 1998 to 'BBB' from 'A'.

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**FY 2006 PROPOSED BUDGET
REDEVELOPMENT AGENCY POSITION IMPACTS**

Department	Position	FTE	General Fund
<i><u>Transfer of the City Redevelopment Agency - Mid Year Change *</u></i>			
Community & Economic Development	Associate Management Analyst	1.00	\$ 89,493
	Clerical Assistant II	1.50	\$ 80,960
	Community Development Coordinator	3.00	\$ 389,666
	Community Development Specialist IV	7.00	\$ 799,780
	Community Development Specialist II	6.00	\$ 527,500
	Executive Secretary	0.80	\$ 61,414
	Information Systems Technician	0.60	\$ 44,012
	Legislative Recorder I	1.00	\$ 71,947
	Sub-Total **	20.90	\$ 2,064,772

* The change to the Special Fund would occur approximately 90 days after approval of the budget.

** 1.80 unclassified positions (.80 Department Director and 1.00 Deputy Director) shown on Attachment C will also be transferred to the Special Fund with the 20.90 shown here for a total of 22.70 positions.

**FY 2006 PROPOSED BUDGET
UNCLASSIFIED POSITION IMPACTS**

Department	Position	FTE	General Fund	Non-General Fund	Supplemental
<i>Unclassified Position Reductions Included as \$1.6m Savings in Fiscal Year 2006 Budget (Volume II, Page 74):</i>					
City Manager	Deputy City Manager	1.00	\$ 124,056	\$ 114,514	
Citywide - Human Relations	Assistant to Executive Director (vacant)	1.00	\$ 106,921		
Community & Economic Development	Department Director *	0.80	\$ 156,746		
	Deputy Director (Redevelopment) *	1.00	\$ 161,508		
	Deputy Director (Economic Dev.) **	0.00	\$ 166,024		
Library	Resource Development Officer (Asst.)	1.00	\$ 95,643		
Mayor's Office	Council Representative II	2.00	\$ 211,202		
Park & Recreation	Resource Development Officer	1.00	\$ 121,670		
Police	Assistant Police Chief (vacant)	1.00	\$ 212,576		
Real Estate Assets	Deputy Director (Acquisition & Valuation)	1.00	\$ 171,770		
Special Projects	Program Manager (Asst. Special Events)	1.00	\$ 122,771		
	Sub-Total	10.80	\$ 1,650,887	\$ 114,514	
<i>Unclassified Position Reductions Included in Fiscal Year 2006 Proposed Department Budgets:</i>					
Community & Economic Development	Program Manager (CSC & Homeless Coord.)	2.00	\$ 258,371		
Environmental Services	Deputy Director (vacant)	1.00		\$ 159,403	
Neighborhood Code Compliance	Program Manager (Graffiti)	1.00	\$ 130,200		
	Sub-Total	4.00	\$ 388,571	\$ 159,403	
<i>Additional City Manager Proposed Unclassified Position Reductions:</i>					
Community & Economic Development	Assistant Department Director	1.00			\$ 180,535
	Community Service Center Mgr ***	3.00			\$ 350,185
Development Services	Assistant Deputy Director (Support Svcs)	1.00		\$ 163,169	
Engineering & Capital Projects	Asst Deputy Dir (Water/Wastewater Facil)	1.00		\$ 156,132	
Environmental Services	Assistant Deputy Director (Resource Mgmt)	1.00		\$ 163,081	
General Services	Deputy Director (Central Stores/Publ Svcs)	1.00		\$ 163,168	
Metropolitan Wastewater	Asst Deputy Dir (Engineering & Prog Mgt)	1.00		\$ 156,132	
	Sub-Total	9.00	\$ -	\$ 801,682	\$ 530,720
	TOTAL	23.80	\$ 2,039,458	\$ 1,075,599	\$ 530,720

* These positions are currently funded by the General Fund and will be moved to the newly created Special Fund, funded by tax increment approximately 90 days after the fiscal year begins.

** This position is currently funded by the General Fund, and as of July 1, 2005 will become reimbursable, funded via Non-General Fund revenue sources.

*** These 3.00 Community Service Center (CSC) Managers were full time CSC Managers. The other CSC Managers were working half as CSC Managers and half in home departments, and will return to their home departments.